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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

January 6, 1994

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street N.W.
Room 222
Stop Code 1170
Washington, D.C. 20554

Re: MM Docket 92-266 - Ex Parte Presentation

Dear Mr. Caton:

Pursuant to Section 1.1206 of the Commission's Rules, enclosed are two copies of a letter from James O. Robbins, President of Cox Cable Communications, which was delivered today to the Chairman. The letter and attached "white paper" discuss issues that are before the Commission in the above-referenced proceeding.

Very truly yours,

Alexander Netchvolodoff

Alexander Netchvolodoff
Vice President of Public Policy

AN/
Enclosures

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COPY

Cox Cable
Communications
A Division of Cox Enterprises, Inc.

James O. Robbins
President

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JAN - 6 1994
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

January 6, 1994

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

Dear Mr. Chairman:

Your recent announcement that you intend to focus your attention on the implementation and enforcement of the Cable Consumer Protection and Competition Act of 1992 and also to bring to bear, on those matters, the principles of "reinventing government" that have recently been set forth by the Vice President is an exciting and encouraging development. In my view, there could not be a better time, nor a better set of principles to bring about a fresh examination of the Commission's approach to cable rate regulation.

Last year, the Commission struggled under herculean time constraints and severe political pressures to complete the multitude of rulemaking proceedings required by the Cable Act. Its output has been truly amazing. However, given these constraints and pressures, the Commission's rate regulation framework is far from perfect. Moreover, it has produced some unintended effects that are directly at odds with the objectives of "reinventing government". While rate regulation is an inherently cumbersome and imperfect means of replicating marketplace conditions, I do believe that it is possible to implement the Act's provisions in ways that do not interfere so pervasively with the ability of the cable industry to attract capital, to invest in job-creating facilities and programming that make its service more attractive to consumers, and to market its service in the most consumer-friendly manner. And there are regulatory mechanisms that are more streamlined and efficient and that do not require two levels of duplicative government regulation where one would suffice.

Cox Cable prides itself on its responsiveness to its customers. Our customer service record speaks for itself. In the past three years, Cox Cable systems have won five CTAM Customer is Key awards and have had six systems selected as finalists in this competition. In addition, we are very proud that every one of our systems has received the NCTA Seal of Good Customer Service. The short term price for this outstanding service is steep -- millions of dollars from our bottom line. But we are convinced that the long term rewards of having satisfied customers is worth every penny.

Likewise, Cox Cable is a leader in capital improvements. We already have 2242 route miles of fiber optics in place -- a higher percentage of total plant miles than any other cable MSO. And we have projected that we will install an additional 2691 route miles of fiber over the next five years at a cost exceeding $87 million. Our total capital budget for this time period is in excess of $687 million. Why are we spending these large sums of money? Because this is what the customer wants and, like yourself, we strive to be responsive to our customer.

All the while, Cox Cable has been able to keep its rates moderate. In fact, even though the new rate regulation rules will cost us over $30 million in revenues this year alone, over 95 percent of our systems had rates within 10 percent of the new benchmarks, and many had rates that were below the benchmarks.

As you can see, Cox Cable has historically been responsive to our customer without excessive rates. We recognize that rate regulation is now required by law, but we are asking that the rules allow us and other cable operators the flexibility - - which the law permits - - to respond to our customers.

We at Cox Cable obviously have our own interests, as well as those of our subscribers, at stake in the Commission's rate regulation proceedings. But those interests are, in this case, wholly consistent with the principles and priorities of "reinventing government" -- which is why we look forward so enthusiastically to your efforts to apply those principles and priorities to a review of the rate regulation rules. Ours is a company that has maintained an undisputed and public record of rate moderation and a strong financial commitment to customer service and infrastructure improvement. I believe that good citizenship should be rewarded and bad citizenship punished under any well-conceived regulatory framework.

To this end, I am forwarding a paper that sets forth some of the problems, both substantive and procedural, with the current rules and some proposals for achieving the Act's objectives with fewer undesirable side effects. A summary of the proposals is attached to this letter. The paper describes the general effects of the rules. I would, of course, be happy to provide you with information regarding some of the specific effects that the rules have had on Cox Cable and on our subscribers, suppliers and investors.

I am most anxious to meet in person to discuss these and other matters facing the cable industry and the Commission as soon as it may be convenient for you to do so. This is an exciting time to be in the business of communications. Companies like ours have great opportunities to find new ways to meet the communications needs and demands of consumers. And you have a great opportunity to develop a regulatory environment that ensures that those needs and demands are met in the most effective and efficient manner.

I wish you the best as you begin your adventure at the Commission and look forward to working with you in the future.

Very truly yours,

Jim Robbins

James O. Robbins

JOR/mc
Enclosure
cc: Commissioner Andrew C. Barrett
Commissioner Ervin S. Duggan
Commissioner James H. Quello
Mr. William F. Caton, Acting Secretary (Ex Parte Memorandum, MM Docket No. 92-266)

PROPOSALS

1. **Abandon tier neutrality - -**

Commission should either (1) establish more liberal benchmarks for cable programming service tiers, or (2) if all tiers (basic and non-basic) are to be subjected to benchmarks based on rates charged by systems subject to effective competition, then non-basic rates should be deemed OK if the average per-channel rate for all regulated tiers (basic and non-basic) does not exceed the benchmark.

2. **Fix the benchmarks - -**

Benchmarks (at least for non-basic rates) should not be based on the <u>average</u> rates charged by systems subject to effective competition. Rates should be deemed reasonable if they are within the range of rates charged by systems subject to effective competition (excluding those at the uppermost end of the distribution).

Benchmarks should be calculated separately for systems with more than 5000 subscribers and systems with fewer than 5000 subscribers.

3. **Fix the price caps - -**

Broaden the scope of "external costs" to allow pass-throughs for capital expenditures and system upgrades, on a phased-in basis.

Allow systems with below-benchmark rates to increase rates to benchmarks.

Allow operators to pass through not only increases in programming costs (in excess of inflation) but also a reasonable profit on such increased programming costs.

Allow pass-throughs that take into account the time value of money, given the regulatory lag that results when rate increases are taken a substantial time after the cost increases that they are meant to cover are incurred.

4. **Adopt streamlined test for justifying rates that do not <u>unreasonably</u> exceed benchmarks - -**

Systems with rates that substantially exceed benchmarks should have burden of proving that rates are cost-justified, but systems with rates that are within a reasonable range of benchmarks should not be required to undertake full-blown cost-of-service showings; the Commission should adopt a checklist of justifying factors, and should approve rates within a reasonable range of benchmarks if system meets one (or several) of the checklist tests.

5. **Eliminate unnecessary and redundant regulation - -**

Allow franchising authorities to decertify and terminate regulation (by them and by FCC) of basic rates.

Do not require a system that relies on cost-of-service showing to justify above-benchmark rates on one tier to justify all tier rates in cost-of-service proceedings, even if rates are at or below benchmarks.

CABLE RATE REGULATION;
AN OPPORTUNITY FOR REINVENTING GOVERNMENT

COX CABLE COMMUNICATIONS

JANUARY 1994

INTRODUCTION

Implementing the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 is a task well-suited to serve as an experiment in "reinventing government". Rate regulation is a risky enterprise, especially when applied to a dynamic industry that is poised to play a major role in the emerging video and telecommunications marketplace. If not implemented properly, it will impair rather than promote growth and competition and will interfere with deployment of a competitive, job-producing National Information Infrastructure. Rate regulation can thwart growth and competition if it sets rates too low or if it provides disincentives to invest in facilities, programming or customer service that would create increased consumer satisfaction and demand. And it can stifle development by imposing costs, delays, and uncertainty on cable operators and on those who supply programming, equipment, and financing to the cable industry.

Faced with severe time constraints, the Commission has so far not been wholly successful in avoiding these problems. The problem is not simply that the existing rules set rates at levels that are too low; it is that they also unduly constrain flexibility in the selection and packaging of services to meet marketplace demands. The overall effect will be - - indeed, already has been - - to squelch investment and thwart the ability of cable operators to provide the sorts of services and facilities - - old and new - - that would appeal to consumers and would stimulate economic growth. Moreover, the procedural requirements result in unnecessary and duplicative layers of regulation, compounding the costs to operators and to the government. Finally, the rulemaking process has created confusion, uncertainty and unnecessary adjustments and readjustments to rates and program offerings, because rate regulation has begun before all the standards, rules and forms associated with such regulation have even been adopted in the first place, much less been refined or clarified on reconsideration.

The Act's rate regulation provisions were principally intended to deal with a single perceived problem - - the lack of effective competition in the provision by cable operators of non-premium services. Ideally, rate regulation would replicate marketplace conditions, so that a system's rates, expenditures and services under regulation would match what would have been the case if it were subject to competition. Unfortunately, however, there is no accurate and reliable way to guarantee such an outcome through regulation.

Traditional cost-of-service regulation is designed to ensure, on a case-by-case, basis, that rates do not exceed costs plus a reasonable profit. But such regulation is costly and time-consuming, and it depends on accurate ways of valuing a company's capital investment, of identifying and properly allocating the company's costs, and of determining what rate of return is appropriate to the risks involved and is necessary to attract sufficient capital - - and, with respect to the cable television industry, no such ways currently exist. Moreover, as the Commission has recognized, cost-of-service regulation creates perverse incentives to make certain expenditures that do not increase consumer satisfaction would not be made in a competitive environment and to forgo other expenditures that enhance consumer satisfaction and would be made in a competitive environment. In other words, at its best, cost-of-service regulation only ensures that profits are commensurate with expenditures; it does not ensure that the expenditures themselves reflect what would occur under competition.

A less accurate but less burdensome alternative is to estimate what a system would charge in a competitive environment by examining the rates of comparable systems that actually are subject to effective competition. But different systems face different costs, and regulating rates in accordance with "benchmarks" based on the rates of competitive systems could force systems with higher-than-normal (though wholly legitimate) costs to reduce their expenditures and provide a lower quality and quantity of service than consumers would prefer. Any regulatory approach that seeks to set rates at the "competitive" level will almost certainly subject some systems to rates that are not sufficient to cover their costs or to ensure a reasonable profit.

Nevertheless, to the extent that there is a lack of effective competition and to the extent that cable operators have exploited this lack of competition by charging excessively high rates - - and some, no doubt, have done so - - carefully applied rate regulation might at least reduce those rates and increase the availability and affordability of cable service without adversely affecting the quality of service. The Act's provisions leave ample room for such an approach, and the principles of "reinventing government" encourage such an approach.

But the Commission's approach has not yet struck this balance. It goes too far in reducing not only the rates of those systems that most clearly exploited their market power but also the rates of those that did not - - in some cases, subjecting those who restrained themselves the most to more stringent price constraints than those who exercised the least restraint. It is an approach that, by forcing cable operators to undertake costly and time-consuming cost-of-service showings to justify rates that exceed stringent benchmarks or rate increases that exceed inflation, deters cable operators from making the sorts of investments that would make cable service more attractive to consumers. And it is an approach that, by artificially and unnecessarily requiring that the average per-channel rates for all tiers be identical, prevents cable operators from offering a low-priced tier of basic service that would maximize the number of consumers to whom cable service is affordable and desirable.

Moreover, the costs of the regulatory process itself are so excessive as to hamper the ability of cable operators to meet the needs and demands of their subscribers. The rules and forms, to the extent that they exist, are unduly complex and require excessively frequent adjustments and recalculations - - in turn requiring excessively frequent (and confusing) rate changes for consumers. To the extent that the forms for calculating rate adjustments or the standards governing cost-of-service regulation do not yet even exist, cable financing is subject to crippling uncertainty and unpredictability.

Finally, the Commission's rules impose unnecessary layers of duplicative regulation. For example, once a franchising authority has opted to regulate basic rates pursuant to the Commission's standards, either the franchising authority or the Commission must continue to regulate those rates pursuant to those standards, even if the franchising authority subsequently decides that such regulation is unnecessary or detrimental to its residents. Moreover, the Commission has decided that a cable system that needs to engage in burdensome and expensive cost-of-service proceedings in order to justify its above-benchmark rates must invoke such proceedings with respect to <u>all</u> its regulated tiers - - <u>even if</u> the rates for such tiers are at or below levels deemed reasonable and permissible under the Commission's benchmarks.

In sum, the Commission was given the monumental task of creating and implementing, within a very short time period, a comprehensive framework for regulating cable rates, and it succeeded in initiating regulation less than a year after receiving its legislative mandate. But, not surprisingly, the framework that the Commission adopted under such time constraints has certain flaws - - and those flaws will result in precisely the sorts of problems that the principles of "reinventing government" are meant to remedy. Specifically, instead of promoting economic growth and jobs, the rules will unduly stifle investment and economic growth in an emerging industry; instead of streamlining government, they will result in unnecessary and redundant layers of regulation; and instead of making government more customer-friendly, they will cause excessive disruption and confusion for cable operators and subscribers. But with petitions for reconsideration pending, the Commission now has a great opportunity to review the rules from the fresh perspective of "reinventing government", and to recast the regulatory framework in a way that, while still restraining excessive rates, promotes the goals of economic growth, efficient regulation, and a user-friendly government.

I. **WHAT'S WRONG WITH THE BENCHMARKS?**

Despite the Act's clear mandate to establish different standards for basic and non-basic rate regulation based on different factors and different policy objectives, the Commission decided that the rates for all tiers of service should be subject to the same standards and benchmarks. In the Commission's view, whether basic rates are "reasonable" and whether non-basic rates are "unreasonable" are to be determined by the same standard: Do the rates exceed what would be charged if the system were subject to effective competition?

Neither the language of the Act nor the legislative history supports this decision. But even if the Act had required that the reasonableness of all tiers be judged by the same standard of whether they reflect "competitive" rates, the existing benchmark scheme would be unduly constraining. First, the establishment of a single, "tier-neutral" benchmark for each system - - so that the maximum per-channel rate is the same for each tier of service - - artificially and unnecessarily limits flexibility in the packaging of cable programming. Second, the Commission used a flawed methodology to establish its benchmarks, so that the benchmarks are, for many systems, substantially below what those systems would charge if they were subject to effective competition.

A. <u>Tier neutrality does not reflect competitive behavior and is not in the public interest</u>.

The Commission attempted to determine what a system's combined average per-channel rate for all tiers of regulated service would be if that system were subject to effective competition. Then, it established that average rate as the maximum permissible rate for <u>each</u> tier of service. This makes no sense. There is no reason to expect that systems that are subject to effective competition would offer basic and non-basic tiers at identical per-channel rates. And there is no public policy reason for compelling non-competitive systems to do so.

The most obvious effect of the Commission's approach is to prevent cable systems from offering a low-priced basic service in a manner that maximizes the number of consumers to whom at least some cable service, including a full range of network, independent and noncommercial broadcast stations, is available. The Act requires that all broadcast signals be included in the basic tier, and it requires that basic service be provided to <u>all</u> subscribers. Since subscribers do not have the option of buying a non-basic tier without buying basic service, all that matters, for subscribers who choose to purchase the optional non-basic tiers, is the <u>combined</u> price for basic <u>and</u> non-basic service. It makes no difference to these subscribers whether the per-channel rates for basic and non-basic service are the same or whether one is higher than the other.

For subscribers who choose only the basic tier, on the other hand, a requirement that all tiers have the same per-channel rate obviously makes a very real difference, depending on whether, in the absence of such a requirement, the basic tier's per-channel rate would have been higher or lower than the non-basic rate. It is difficult to imagine why the Commission would want to prevent cable systems from charging less for basic and more for non-basic service, assuming the same overall per-channel rate. A lower-priced basic tier could benefit all subscribers and would harm none. Basic-only subscribers would pay less; subscribers to the combined package of basic and non-basic tiers would pay the same.

Why would a cable operator choose such a pricing strategy, if the only effect is to lower the rates of basic subscribers? Obviously, he would do so only if he expected that revenues from new subscribers offset revenue losses from (1) lower basic rates paid by existing basic subscribers and (2) the decision of some full-service subscribers to cut back to the lower-priced basic service. A pricing strategy that adds new subscribers (and, as a result, might even <u>lower</u> the rates paid by <u>all</u> subscribers) ought to be encouraged, not discouraged by the rules.

It is also conceivable that a cable operator might, in the absence of a requirement that all tiers have equal per-channel rates, opt to charge more for basic than for non-basic tiers. In this scenario, once again, subscribers to the combined package pay the same amount as under a tier-neutral approach, but basic subscribers pay <u>more</u>. Such a pricing strategy might be necessary if a cable system wanted to provide a range of services more costly than broadcast stations on its basic tier; to the extent that, if such a basic package were offered, more subscribers opted for basic only and fewer purchased the optional tier, the cable operator would have to charge higher basic rates to ensure that he could recover his costs.

But such a strategy would increase the price of the lowest-priced tier of service and therefore diminish the availability of cable to those least able to afford it. If the Commission wanted to discourage this result, it could require that the <u>basic</u> rate and the <u>combined</u> basic and non-basic rate (as measured on a per-channel, <u>per-subscriber</u> basis) <u>each</u> not exceed benchmark levels. But there is no reason at all to prevent non-basic rates from exceeding benchmark levels, so long as the combined rate does not. As we have shown, nobody subscribes only to the non-basic tier; preventing rates for that tier from subsidizing rates for the basic tier serves no legitimate purpose.

B. <u>The Benchmarks Are Methodologically Flawed and Too Low When Applied To All Tiers of Cable Service.</u>

If the Commission had only required that <u>basic</u> rates be set at the rates charged by systems subject to effective competition and had, as the Act contemplates, established a more flexible ceiling on non-basic or overall rates, the precision with which the competitive benchmarks were established would have been less critical. The problems of excessively low basic benchmarks would have been mitigated by the ability of systems to make up some of the shortfall from non-basic charges.

But once the Commission decided that all tier rates should be subject to the same competitive benchmarks, it became imperative that the benchmarks accurately reflect competitive rates and allow even those systems with higher than average costs to recover those costs plus a reasonable profit. The Commission's benchmark methodology, however, was hardly sufficient to ensure that this would be the case. Indeed, that methodology virtually ensures that, for many cable systems, it will not be the case.

First, the Commission's benchmarks are based on the average rates charged by systems subject to effective competition. But even half the systems that are subject to effective competition charge rates that are higher than the average. Rates of competitive systems vary for a number of reasons, including the variation in the costs that they incur. The same is true for systems that do not face effective competition. Systems with above-average costs would not, if they were subject to effective competition, charge the same rates as systems with average costs and average rates. To establish benchmarks based on such average rates is only to ensure that, for more than half the systems subject to rate regulation, the benchmarks will be too low to cover costs plus a reasonable profit. These systems will have no choice but to cut back on expenditures or take their chances in costly and, so far, standardless cost-of-service proceedings.

Second, the Commission's benchmark scheme is based on the invalid assumption that, as a general matter, rates of systems subject to effective competition are approximately ten percent lower than rates charged by systems that are not subject to effective competition. The Commission's survey of cable rates showed that the difference between the average rates charged by competitive and non-competitive systems as of September 30, 1992 was approximately ten percent. The Commission's benchmark calculations and its determination that above-benchmark rates should be rolled back to benchmark levels or to ten percent below the system's combined per-channel rate for basic and non-basic tiers on September 30, 1992 (whichever is higher) were based on an assumption that the ten percent difference between competitive and non-competitive systems applied across the board to all systems.

But this assumption was wrong. The Commission's own survey data clearly shows that, for systems with more than 5,000 subscribers, there was no significant difference between the rates of competitive systems and the rates of non-competitive systems. Therefore, there is no basis at all for requiring rate reductions among systems with more than 5,000 subscribers. To impose such reductions will simply require such systems to charge less than comparable systems subject to effective competition - - and, in order to do so, to cut back expenditures (if possible) on programming, maintenance and improvement of facilities, and customer service.

II. WHAT'S WRONG WITH THE PRICE CAPS?

Because the benchmarks are too low to ensure that systems will earn a reasonable return on their investment, a majority of systems have been required, with the onset of regulation, to roll back their rates to levels that necessitate cutbacks on expenditures and prevent further investment - - or to initiate cost-of-service proceedings. These unfortunate effects are, however, compounded by the Commission's "price cap" approach to limiting future rate increases.

Specifically, that approach allows systems to increase rates without initiating cost-of-service proceedings in only two circumstances. First, systems may increase rates annually by an amount that reflects the annual rate of inflation. Second, systems may increase rates as often as quarterly to cover any increases in "external costs" that exceed increases attributable to inflation (but must reduce rates to the extent that external costs decrease or increase by less than inflation).

One problem with this approach is that the definition of "external costs" is narrow and excludes a wide range of wholly legitimate expenditures that a cable system might make to maintain or improve the quality and attractiveness of its service. External costs include only programming costs, taxes, franchise fees and costs of complying with franchise requirements. They do not include, for example, expenditures on facilities, including system upgrades, nor do they include expenditures on improved customer service - - even though the Act's new customer service requirements ensure that systems will have to incur substantial additional expenditures. Systems that make such expenditures will be forced to justify any rate increases that they necessitate in cost-of-service proceedings. Moreover, because such proceedings are time-consuming and burdensome - - and because the outcome of such proceedings will always be uncertain - - the Commission's stringent price caps may ultimately deter systems from making expenditures that are in any way discretionary.

Even for those expenditures that do clearly fall within the definition of "external costs", the allowable pass-throughs are insufficient to provide adequate compensation and, indeed, to provide incentives to make the expenditures in the first place. The rules allow operators to pass through cost increases to the extent that they exceed inflation, but they do not permit recovery of any profit on the increased investment. In many instances, this will eliminate any incentive to incur increased costs, even if such investments would make cable service more attractive to consumers.

This will not always be the case. Where, for example, an investment in improved programming is expected to attract a substantial number of new subscribers to a tier of cable service, the additional revenues from those new subscribers might enable an operator to recover not only his costs but also a reasonable incremental return on the investment. But it is increasingly the case that the addition of new services to a programming tier is designed not to attract new subscribers but to sell additional service to existing subscribers. Cable operators would have no incentive to add services in these circumstances, however, if they expected to recover no more than their increased costs. To provide such an incentive, therefore, the Commission needs to include a profit component in the allowable rate increases attributable to external cost increases.

Moreover, the current procedures for increasing rates in accordance with the price caps will create a regulatory lag that will prevent cable operators from ever fully recovering their increased costs. Systems are allowed to increase rates on account of inflation once a year, based on the inflation rate for the previous year. What this means is that rates in the month that the increase is taken will (at least in theory) accurately reflect existing costs. But for each of the preceding 11 months, as costs increased as the result of inflation, rates were frozen at rates that could not cover those increases. And for each of the next 11 months, rates will be stuck at a level that does not cover the monthly increases in costs.

A similar but possibly less severe problem exists with respect to increases in "external" costs, such as the costs of programming. The problem is less severe only because rate increases to pass through such external cost increases may be implemented on a quarterly basis. But even quarterly increases will incorporate a degree of regulatory lag - - and, in any event, such frequent increases are annoying and confusing to consumers and, consequently, are undesirable for cable operators. To eliminate the stifling effects of regulatory lag, the Commission should incorporate into its price caps a mechanism for recovering the full amount of increased costs, even though rate increases do not occur until several months after most of those increased costs have been incurred.

Finally, the Commission's price caps are harshest on the systems like ours that restrained themselves the most and maintained the lowest rates during the several years of deregulation. Even if a system's initial rates are below benchmark levels, it is subject to the same price caps as all other systems; it can only pass through inflation and external cost increases and cannot even automatically raise rates <u>to the benchmark level</u>. According to the Commission, the fact that a system's rates are below benchmarks indicates that the system must be covering its costs plus a reasonable profit at those rates and that any higher rates would therefore be unreasonable. At the same time, the Commission assumes that systems with rates above benchmarks are charging more than their costs plus a reasonable profit and requires that they reduce their rates.

Actually, although these contradictory assumptions operate to the disadvantage of the cable operator in both situations, the rules end up punishing most severely those with the lowest rates. Systems with rates in excess of benchmarks are never required to reduce their rates to less than the benchmarks and also are not required to reduce their rates by more than 10%, even if this still leaves rates well in excess of benchmarks. But systems with rates below benchmarks are not allowed to raise their rates to benchmark levels; indeed, they are not allowed to raise them at all!

It simply is not true that whatever a system is charging at any given point in time will always be at least sufficient to cover the systems costs plus a reasonable profit. Systems often incur substantial expenditures that cannot immediately be passed through to subscribers in their entirety. To maintain subscribership, systems may be required to increase rates to cover such expenditures gradually. This means that existing rates could not, in such circumstances, cover costs plus a reasonable profit unless the system were permitted to increase rates periodically by more than inflation.

By freezing the rates of below-benchmark systems at existing rates and allowing increases only for inflation and future increases in external costs, the Commission will unfairly prevent these systems from ever recovering their costs plus a reasonable return on investment. And it will also deter such systems from making future investments to upgrade facilities , since such investments will not be treated as external costs. To the extent that systems with below-benchmark rates may be those whose costs are low because they have not yet invested in system upgrades, the Commission's rules unfairly forestall such upgrades and other improvements in the quality of service available to subscribers.

III. THE RULES ENCOURAGE UNNECESSARY AND DUPLICATIVE REGULATION.

To the extent that the rules, as shown above, deter investment in the deployment of new technology and system improvements - - investment that would not only improve the quality of service available to subscribers but would also create jobs, stimulate the economy, and provide a shot in the arm to the private development of a National Information Infrastructure - - they would appear to be directly at odds with the objectives of "reinventing government". Moreover, as we now show, the Commission's approach has not only made government less responsive to the desires of consumers and the needs of the national economy; it has also opted, wherever there is a choice, for more government rather than less - - for two layers of rate regulation where one would be more than sufficient.

The Act's dual regulatory scheme assigns the task of regulating basic rates to local franchising authorities. The Act gives franchising authorities the opportunity to decide that, even where effective competition does not exist, basic rates should not be regulated. Franchising authorities do not have to regulate rates; indeed, they cannot do so unless they certify their desire and willingness to do so pursuant to the Commission's standards. If they certify but do not have the resources or the legal authority to regulate, the Commission may deny or revoke their certifications and regulate basic rates itself. But if the franchising authority opts not to certify, the Commission has no authority to step in and regulate basic rates.

The Commission's rules intrude, however, on the discretion of local franchising authorities to decide that regulating basic rates in accordance with the Commission's standards would not be in its residents' best interests. First, the rules do not give franchising authorities the opportunity, once they have opted for regulation, to decertify - - to decide that basic regulation under the Commission's standards is not a good idea. Under the rules, a city that made such a